

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 00-0127

**Gross Income Tax
For Tax Years 1995 through 1997**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Gross Income Tax—Advertising Income

Authority: IC 6-2.1-2-2; IC 6-2.1-2-2(a); IC 6-2.1-2-3; IC 6-2.1-2-4(2); IC 6-2.1-2-5
45 IAC 1-1-87

Taxpayer protests the assessment of Indiana gross income tax at the high rate on the income taxpayer received for providing advertising.

II. Tax Administration—Abatement of Penalty

Authority: IC 6-8.1-10-2.1(d)
45 IAC 15-11-2; 45 IAC 15-11-2(c)

Taxpayer protests imposition of a ten percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer is a subsidiary of a large retail bookstore, and an operator of retail bookstores located primarily in shopping malls. In addition to the income generated from the sale of books, taxpayer receives income from book publishers under co-op advertising contracts. For a fee, taxpayer will advertise publishers' books and their authors in taxpayer's print, radio or television advertisements, in catalogs, on customer receipts, or on in-store displays.

After a routine audit for the years in question, the Department of Revenue issued a notice of proposed assessments. In determining the assessment, the Department's auditor apportioned the income taxpayer received from advertising and included said amount as

gross income to be taxed at the high rate. Taxpayer protests the portion of the proposed assessment which characterizes the advertising income as high rate gross income rather than low rate gross income.

I. Gross Income Tax—Advertising Income

DISCUSSION

Taxpayer argues that the revenue generated from its sale of advertising to book publishers is considered display advertising, and is taxable at the low rate for gross income tax purposes. Indiana's Gross Income Tax encompasses most receipts of income. Pursuant to IC 6-2.1-2-2(a), "[a]n income tax, known as the gross income tax, is imposed upon the receipt of: (1) the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana . . ." Gross income tax is imposed at one of two rates. IC 6-2.1-2-3. These rates are generally referred to as the high and low rate. In determining which of the two rates is to be applied, we look to the type of transaction from which the taxable gross income is received. IC 6-2.1-2-2.

Income received from display advertising is taxable at the lower rate. Income from display advertising includes the gross receipts derived from advertising in newspapers, magazines, periodicals, other similar advertising media, outdoor posters and painted displays, and sales of time to local or national advertisers by radio and television stations. 45 IAC 1-1-87; IC 6-2.1-2-4(2). Display advertising does not include the sale or rental of tangible property or any personal professional service rendered in connection with such advertising. *Id.* The high gross income tax rate, however, applies to gross income received from (among other things): ". . . (9) any activity which is not described in section 4 of this chapter including the provision of services of any character, sales of real estate, rentals (except rentals described in section 4(6) of this chapter), the performance of contracts, and the investment of capital." IC 6-2.1-2-5 (emphasis added).

Subsequent to the protest hearing, taxpayer submitted copies of co-op advertising contracts that it entered into with various publishers. According to taxpayer, the process of entering the contracts is as follows. Taxpayer's marketing department decides to run a promotion. Taxpayer's marketing department then contacts publishers to determine whether or not publisher would like its books to be included in the promotion. If the publisher agrees to participate in the promotion, a verbal agreement is reached and taxpayer's marketing department sends a contract to the publisher stating the cost of participating in the promotion. The publisher's payment for participating in the promotion is made via chargeback (*i.e.*, an offset to the amount taxpayer owes for the cost of publisher's books).

In their format, we find that taxpayer's co-op advertising contracts are agreements on the part of publishers to make payments to taxpayer for taxpayer's services for providing advertising and otherwise promoting the sales of the books. The services provided are the inclusion of publishers' books in taxpayer's newspaper, radio, and television

advertisements, and the featuring of the books in taxpayer's store displays, receipts, and catalogs. Although taxpayer states that the total income received from publishers for the promotions is nearly equal to the cost of running the promotions, the contracts belie the statement. The contracts show that the specified rates are merely measures for determining the value preceding or accruing from the service. No contracts submitted provided that the payments be in the exact amounts of expenses incurred in the performance of services.

Careful review of the information of file and all of the documentation provided by taxpayer leads us to the conclusion that the income that taxpayer receives from publishers is not display income, but instead constitutes income generated from taxpayer's provision of services. We, therefore, find that the income in question is taxable at the high rate for gross income tax purposes.

FINDING

Taxpayer's protest is denied.

II. Tax Administration— Abatement of Penalty

DISCUSSION

Taxpayer protests the imposition of a ten percent (10%) negligence penalty.

IC 6-8.1-10-2.1(d) states that if a person subject to the negligence penalty imposed under said section can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty. 45 IAC 15-11-2 defines negligence as the failure to use reasonable care, caution or diligence as would be expected of an ordinary reasonable taxpayer. Negligence results from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or Department regulations.

In order to waive the negligence penalty, taxpayer must prove that its failure to pay the full amount of tax due was due to reasonable cause. 45 IAC 15-11-2. Taxpayer may establish reasonable cause by "demonstrat[ing] that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed" 45 IAC 15-11-2(c). In determining whether reasonable cause existed, the Department may consider the nature of the tax involved, previous judicial precedents, previous department instructions, and previous audits. *Id.*

In this case, the Audit Division imposed the penalty because it found that taxpayer failed to report revenue agent report changes, and failed to include the income generated from the promotion services as income subject to gross income tax. Taxpayer contends that it did, in fact, make reasonable efforts in filing tax returns and making timely payments. Taxpayer also maintains that it had every intention of paying its proper tax liability.

While taxpayer has attempted to offer an explanation for its tax discrepancies, taxpayer has not shown reasonable cause under 45 IAC 15-11-2.

FINDING

Taxpayer's protest is respectfully denied.

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